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DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 96-0505 ST
SALES AND USE TAX

For Tax Periods: 1993 Through 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

ISSUES

I. Sales/Use Tax-Exemption Certificates:

Authority: IC 6-2.5-3-7

Taxpayer protests the assessment of tax on sales for which Taxpayer produced exemption certificates.

II. Sales/Use Tax-Farming Exemptions:

Authority: IC 6-2.5-5-1, IC 6-2.5-5-2

Taxpayer protests the assessment of use tax on certain items used in farming.

III. Sales/Use Tax-Manufacturing Exemption:

Authority: IC 6-2.5-5-3, Indiana Department of Revenue v. Cave Stone, Inc., 1983,457 N.E. 2nd 520.

Taxpayer protests the assessment of use tax on certain items used in the manufacturing process.

IV. Sales/Use Tax-Unitary Transaction:

Authority: IC 6-2.5-1-1, 45 IAC 2.2-3-5 Sec. 1 (a).

Taxpayer protests the assessment of tax on several transactions that have both parts and labor components.

V. Sales/Use Tax-Like Kind Exchange:

Authority: IC 6-2.5-1-6, 45 IAC 2.2-3-5 Sec. (i).

Taxpayer protests the assessment of tax on a like-kind exchange.

VI. Sales/Use Tax-Credit for Payment of Other Taxes:

Authority: IC 6-2.5-3-5

Taxpayer protests the assessment of tax on several purchases on which taxpayer contends he paid tax to other taxing jurisdictions.

VII. Sales/Use Tax-Safety Equipment:

Authority: **IC 6-2.5-5-3, U.S. Steel Corporation** (1981), Ind. App., 425 N.E. 2d 659.

Taxpayer protests the assessment of tax on certain items of safety equipment.

VIII. Administration-Negligence Penalty:

Authority: IC 6-8.1-10-2.

Taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

Taxpayer is a farming and lumber operation. Taxpayer's lumber operation starts with the harvesting of trees on its farm. Taxpayer then transports the trees to the sawmill area where the machines process the trees into the various end products produced by the mill such as board lumber and mulch. The Indiana Department

of Revenue assessed additional sales and use tax after an audit. Taxpayer timely protested the assessment. Further facts will be provided as necessary.

DISCUSSION

I. Sales/Use Tax-Exemption Certificates

Generally, all purchases of tangible personal property in Indiana are subject to the gross retail or sales and use tax. IC 6-2.5-2-1. Certain purchases are, however, exempt pursuant to specific statutory provisions. Exemptions are to be strictly construed against the party claiming exemption. Indiana Department of Revenue v. Fort Wayne National Corporation, 1995, 649 N.E. 2d 298, 133 L.Ed. 2d 204. Taxpayer argues that several areas of assessment in this audit classify as exempt pursuant to specific statutory provisions exempting those particular transactions.

Taxpayer's first item of protest concerns several sales to customers who claimed that they were purchasing the items for exempt uses. After the audit Taxpayer compiled AD-70s for those sales and enclosed those certificates with the protest letter. Taxpayer's protest to the assessment of additional tax on these sales is sustained.

FINDING

Taxpayer's protest to this assessment is sustained.

II. Sales/Use Tax-Farming Exemptions:

Taxpayer's second item of protest concerns certain materials used in the farming portion of the operation. These items include straw, seed and a fertilizer spreader. Pursuant to IC 6-2.5-5-1 (straw and seed) and IC 6-2.5-5-2 (fertilizer spreader), these purchases would qualify for exemption if they were to be directly used in the direct production of food or other agricultural products for sale. The straw was used for erosion control. This use does not have a direct impact on the production of agricultural commodities. Therefore the protest to this item is denied. The seed in question was clover that was used as a cover crop for the tobacco patch. The cover crop is used to protect and preserve the soil when the tobacco is not actually growing there. Therefore, the cover crop does not directly affect the growing of the tobacco, the agricultural commodity that Taxpayer sells. The protest to this assessment of tax is denied. According to Taxpayer, the farm fertilizer spreader is used 90% of the time for crops and other agricultural commodities and 10% of the time for cover crops. As it spreads fertilizer to enhance the growth of the crops and other agricultural commodities, the fertilizer

is exempt. The 90% of its purchase price attributable to this exempt use is exempt and Taxpayer's protest is sustained for that 90% of its price.

FINDING

Taxpayer's protest is sustained in part and denied in part.

III. Sales/Use Tax-Manufacturing Exemption:

Taxpayer's third item of protest concerns the taxability of folding rules and a Tiger Tool "Kit 300 Deluxe". The folding rules are essentially rulers that could be used for any number of uses. They are not specifically industrial tools that would qualify for the manufacturing exemption from sales tax due to direct use in direct production pursuant to IC 6-2.5-5-3. This point of protest is denied. The Tiger Tool "Kit 300 Deluxe" is a five-piece tool set for heavy-duty trucks. It includes a U-Joint puller, slack adjuster puller, bearing cup installer, brake clevis pin press and tie-rod end remover in a plastic carrying case. Taxpayer's trucks are all fully taxable. Therefore there is no valid reason to exempt these tools. This item of protest is denied.

The fourth item of protest concerns the taxability of paint purchased to mark lumber for inventory control. Taxpayer contends that this paint is qualified for the manufacturing exemption. An item qualifies for this exemption if the item has an immediate effect on the production of tangible personal property and is a necessary and integral part of the production process. Indiana Department of Revenue vs. Cave Stone, Inc., 1983, 457 N.E.2d 520. Paint which is used for inventory control does not meet this test because it is actually a convenience for the taxpayer. It does not effect any change in the product. This item of protest is denied.

Taxpayer also protests the assessment of tax on the use of an oil seal in a 200 amp electric box. An electric box is removed from the production process and does not qualify for exemption. This point of protest is denied.

Taxpayer's next item of protest concerns the assessment of tax on the purchase of a piper saw shop. This is a grinder that sharpens saws to cut the lumber. This is a maintenance item that keeps the saws in a condition so that they can cut the lumber and directly impact the production of Taxpayer's final product. Maintenance items do not qualify for the manufacturing exemptions since they do not directly affect the manufacturing process. This item of protest is denied.

Taxpayer also protests the assessment of tax on O rings purchased for farm tires. Taxpayer could not document that these O rings were used on exempt farm and sawmill machinery. Therefore this item of Taxpayer's protest is denied.

The next item of protest concerns the assessment of tax on the purchase of a Fiat Allis that moves materials in Taxpayer's mulch manufacturing system. The Fiat Allis moves the wood from earlier production processes through the grinding process where it becomes mulch. This use of the Fiat Allis in the production process qualifies for the manufacturing exemption. Production ends, however, at the point when the lumber reaches its final form of mulch. Use of the Fiat Allis to move mulch from the production process to storage is a post production and non-exempt use. The protest is sustained as to the use in the production process. The protest is denied as to the percentage of use of the Fiat Allis after production is completed and it moves the finished product to storage.

Taxpayer also protests the assessment of additional tax on two machines used to haul logs in various capacities including the mulching process. The equipment moves logs in that process approximately 50% of the time. That use qualifies for the manufacturing exemption. Therefore this assessment should be reduced by fifty per cent. This item of protest is sustained to the extent the machines are used to haul logs during the manufacturing process.

Taxpayer's next item of protest concerns the assessment of tax on the purchase of supplies used in leading and repairing the blades for the Chipper. Taxpayer periodically must repair and apply more lead to the blades of the Chipper. This is a maintenance function that is removed from the production process. This purchase does not qualify for exemption.

Taxpayer also protests the additional tax assessed on the purchase of supplies, bearings, fluid and parts for both electrical and gas powered equipment. The auditor reevaluated the machinery involved and determined that the machinery qualified for the manufacturing exemption. This point of protest is sustained.

Taxpayer also protests the assessment of tax on fuel for several of the machines and items of equipment. The auditor and Taxpayer agreed that some of the fuel would qualify for exemption. At Taxpayer's suggestion, they agreed to remove one entire invoice to compensate for the exempt fuel used rather than attempting to prorate each invoice. Taxpayer selected the invoice that was dropped from the assessment. Taxpayer has not presented any more precise records or methods to quantify fuel that was used in exempt machinery and equipment. Therefore, the assessment will stand as originally computed.

Taxpayer's next protest concerns tax assessed on belts used in various machines and vehicles. Taxpayer did not uphold its burden of proving that the belts were used in equipment qualifying for the manufacturing or farming exemptions. This item of protest is denied.

Taxpayer's final protest based on the manufacturing exemption concerns the assessment of tax on industrial electrical extension cords. In this case manufacturing begins with the machine that actually changes the tangible personal property. The cords function prior to the start of this process. They do not have a direct effect on the manufacturing process. This item of protest is denied.

FINDING

Taxpayer's protests are sustained in part and denied in part.

IV. Sales/Use Tax-Unitary Transaction:

Taxpayer's next protest concerns the installation of a floor in a trailer. Taxpayer contends that the auditor incorrectly assessed tax on \$5,200.00 of labor charges. Sales tax is to be computed on the total sales price of any transaction even if labor charges were included in that total sales price unless the labor charges are contracted for separately at the time of sale. IC 6-2.5-1-6, 45 IAC 2.2-I-I Sec. 1. (a). In Taxpayer's case, the invoice seen by the auditor separately listed labor charges in the total amount of \$1485.00. This indicates that Taxpayer contracted to pay \$1485.00 for labor in the installation of the floor. Further evidence that Taxpayer did not separately contract for the \$5,200 in additional labor charges is that the taxpayer did not know that amount when the auditor was performing the audit. Taxpayer needed to call the supplier to learn what that amount was. Clearly Taxpayer could not have separately negotiated the labor charges if Taxpayer did not know what those labor charges actually were. The auditor correctly excluded those separately negotiated and listed labor charges from the taxable sales price in the audit. No other labor charges were separately negotiated or listed on the invoice. Therefore those charges are subject to tax. This point of protest is denied.

Taxpayer also protests the assessment of tax on labor charges for several other purchases. Each of those purchases was for repair to a truck or other piece of equipment. Taxpayer presented invoices that show separately stated labor charges for many of these purchases. Invoices with separately stated labor charges indicate that Taxpayer separately contracted for the labor charges. Taxpayer should not be assessed additional tax on the portion of sales prices for

which Taxpayer produced invoices showing that the labor charges were separately negotiated and stated. This point of protest is sustained.

FINDING

This point of protest is sustained in part and denied in part.

V. Sales/Use Tax-Like Kind Exchange:

Taxpayer protests the assessment of tax on a cable skidder. Taxpayer presented an invoice showing that the total sales price of the cable skidder was \$84,000.00. Taxpayer traded in an old cable skidder at a value of \$36,000.00. This left a balance of \$48,000.00 that Taxpayer paid. The auditor assessed tax on the total value of the cable skidder. The trade in of the old cable skidder was, however, a like kind exchange that is exempt from the tax. IC 6-2.5-I-6, 45 IAC 2.2-3-5 Sec.1 (I).

FINDING

Taxpayer's protest to this assessment is sustained.

VI. Sales/Use Tax-Credit for Payment of other Taxes:

Taxpayer also protests the assessment of tax on several purchasers with no credit given for taxes properly paid to the Federal Government or other states. The law provides a credit for payment of taxes properly paid to other taxing jurisdictions at the time of purchase. It does not provide a credit for taxes paid to the Federal Government. IC 6-2.5-3-5. Taxpayer produced invoices showing that it was not given this credit on several purchases. Taxpayer should have received credit for those taxes paid. Taxpayer should not receive a credit for any taxes paid to the Federal Government.

FINDING

This point of protest is sustained in part and denied in part.

Sales/Use Tax-Safety Equipment:

Taxpayer also protests the assessment of tax on several safety items. Safety items are exempt from taxation if they are necessary and essential for the protection of the employees. An item is considered necessary and essential only if every employee must use it for protection at all times. IC 6-2.5-5-3, Indiana Department of Revenue v. U.S. Steel Corporation (1981), Ind. App., 425 N.E. 2d

659. Taxpayer protests the assessment of tax on the purchase of earplugs. Taxpayer's machinery is loud, but it is not loud enough that all of the employees need to use the earplugs. This point of protest is denied.

Taxpayer also protested the assessment of tax on oil and safety guards for the chain saws used in production. These items are necessary and essential items that are used for the protection of all employees using the chain saws. This item of protest is sustained.

FINDING

Taxpayer's protest is sustained in part and denied in part.

Administration-Penalty:

Taxpayer also protests the imposition of the ten per cent negligence penalty assessed pursuant to IC 6-8.1-10-2. In the instant case Taxpayer's records were not complete. Taxpayer was not able to produce many exemption certificates and invoices at the time of the audit and could not produce them until much later. Purchase invoices indicate that Taxpayer used exemption certificates to purchase personal items, gifts for friends, as well as every item used in any way by the business. This demonstrates that Taxpayer did not make the effort of the reasonable man to pay the appropriate amount of tax in the regular course of his business.

FINDING

This point of Taxpayer's protest is denied.